

The Manufacturers Hanover Financial Digest

Weekly Commentary,
Selected Financial Data,
and Business Indicators

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The Pause In Economic Growth . . .

For all the economy's apparent weakness in the first half of 1985, there may be more strength than meets the eye. While inflation-adjusted output of goods and services (real GNP) increased at an average annual rate of only one percent in the January-June period, the weakness was concentrated in the two most volatile components of output—net exports and inventory investment. In the first quarter of 1985, domestic output was depressed by the increased diversion of domestic demand to foreign producers, resulting in a sharp deterioration in the U.S. net export position. In the second quarter, on the other hand, the principal cause of slow growth was cautious policies by business that resulted in sharply reduced inventory investment.

Last quarter's real GNP, up 1.7 percent at an annual rate, does not reveal the underlying strength of business activity. This is because the gross national product is a measure of domestic output and not of domestic spending. Consequently, rising imports and a slower rate of inventory accumulation can prevent strong consumer and business spending from translating into healthy GNP growth.

Real final domestic demand—real GNP minus net exports and change in business inventories—reveals a surprisingly strong economy in the first half of 1985. Real final domestic demand advanced at an average annual rate of five percent in the January-June period—not much different from the pace of the preceding year. Both the consumer and business sectors were the major forces behind this strength. Consumer expenditures, for example, grew at a seasonally adjusted annual rate of 5.2 percent in the first half of 1985, while business spending for plant and equipment expanded at an annual rate of 5.8 percent.

. . . Was Caused By A Larger Trade Deficit . . .

But this strong domestic demand did not result in a corresponding growth in domestic output. During the first quarter, a surge in imports which soared 32 percent at an annual rate, resulted in a \$15 billion deterioration in the inflation-adjusted net export deficit in the GNP accounts, subtracting 3.6 percentage points from real growth. In other words, if our net export position in the first quarter had

remained unchanged from the previous quarter, then GNP in the first quarter of this year would have grown nearly four percent.

In the second quarter output growth was again retarded by the net export deficit which widened by another \$5.4 billion. This time imports rose only modestly; exports, however, posted their largest drop in 2½ years. The drag from net exports depressed real GNP growth by 1.3 percentage points.

But the principal cause of sluggish output growth in the April-June period was a reduction in the rate of inventory investment. The \$5.8 billion increase in inflation-adjusted business inventories in the second quarter marked a significant slowdown from the \$19.1 billion accumulation pace of the previous quarter. It reduced real GNP by more than \$13 billion, subtracting an additional 3.4 percentage points from the second quarter's growth. Indeed, if inventory spending in the April-June period had matched the first quarter's rate, real GNP would have increased by five percent. And if the effects of both the diminished rate of inventory investment and the widening trade deficit are removed, the pace of economic growth in the second quarter picks up from the reported 1.7 percent to more than six percent.

. . . And Slower Inventory Accumulation

The slower pace of economic growth in first-half 1985 was a continuation of a trend which began last summer. At that time, the robust growth of the early stage of the business recovery switched to a more moderate pace. Thus, after rising at a sizzling seven percent clip, on average, during the first six quarters of the current business upswing, real GNP in the last four quarters expanded at a more subdued two percent pace. This is not an unusual development. Indeed, the slower pace of business activity over the past year mirrors similar patterns of some of the other longer postwar recoveries.

Vigorous growth in the earlier stages of those expansions that lasted this long was also followed by a period of subdued economic performance for two to five quarters, with the growth rate of real output



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averaging approximately two percent. This growth pause was often followed by another phase of stronger activity before the expansion's demise. In this respect, the current experience seems to be typical. Already, last week's economic statistics for June point to a pickup in the pace of business activity toward the end of the second quarter.

What's more, the third quarter appears to have gotten off to a good start. According to the Bureau of Labor Statistics, July's non-farm payroll employment posted a gain of 250,000 jobs. Most of July's job increases occurred in the service sector, since manufacturing payrolls held steady after falling in the previous five months. The civilian

unemployment rate remained at 7.3 percent.

Another sign suggesting that the economic pulse may be quickening came from the Commerce Department's index of leading economic indicators. The index, which tends to foreshadow future business trends, posted a strong gain of one percent in June, reaching an all-time peak.

Other signs that point to a resumption of the economy's strength in the July-September period include June's two percent jump in new orders for manufactured goods, an increase in consumer confidence, continued gains in personal incomes, June's 0.7 percent rise in construction spending, and

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 7/31/85	% Change Since	
		Week Ago	Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies			
Owned Outright & RPs	174.926	- 1.724	+ 16.456
Loans to Depository Inst.	.950	+ .066	- 6.510
Floater	.726	+ .193	+ .358
Total Reserve Bank Credit	186.249	- 1.233	+ 13.883
Treasury Deposits with			
Federal Reserve Banks	3.725	+ .143	- .454
Currency in Circulation	186.561	- .476	+ 11.206
Gov'ts held for Foreign Acct.			
by F.R. Banks (End-of-Week)	125.643	- .006	+ 10.597
Member Bank Reserves:			
Total Reserves Held	41.878	- 1.051	+ 4.660
Excess (Deficiency)	.837	+ .140	+ .202
Net Free Reserves	.428	+ .530	+ .847
		% Change Since	
		Three Months Ago*	Year Ago
Monetary Aggregates†			
M1 (7/22/85)	595.4	+ 14.0‡	+ 8.7‡
M2 (June '85)	2,473.1	+ 7.2	+ 9.0
M3 (June '85)	3,183.5	+ 6.3	+ 9.3
Domestic Nonfinancial Debt	6,147.0	+ 11.3	+ 13.6
(1st Q'85)			

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

	3 Months	6 Months	1 Year
Offering Rates 8/2/85			
‡ U.S. Treasury Bills	7.30%	7.47%	7.64%
* Federal Agencies	8.00	8.05	8.40
* Municipal Notes—High Grade (46% Taxable Equivalent)	8.33	8.80	9.26
Negotiable Time CDs			
Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.75	8.00	8.45
‡ Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	7.75%	Sep.	7.80%
15- 29 days	7.75	Oct.	7.80
30- 59 days	7.75	Nov.	7.85
60- 89 days	7.75	Dec.	7.90
90-179 days	7.75	Jan.	7.92
180-239 days	7.75	Feb.	7.92
240-270 days	7.75		
‡ Industrial Paper—Prime			
30- 89 days	7.75%	† Federal Funds	
90-120 days	7.75	Effective Rate	7.95%
‡ Discount basis.		* Subject to availability.	† Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'85	\$ 3,854	\$ 3,811	\$ 3,645
Gross National Product (1972 Dollars)*	2nd Q'85	\$ 1,671	\$ 1,664	\$ 1,639
Percent Change, Annual Rate	2nd Q'85	1.7	0.3	7.1
Change in Consumer Prices*	Jun '85n	2.4%	2.4%	2.4%
Change in Producer Prices*	Jun '85	0.0%	2.4%	0.0%
Civilian Employment (Thousands of Persons) †	Jul '85n	106,862	106,370	105,377
Unemployment as % of Civilian Labor Force †	Jul '85n	7.3%	7.3%	7.5%
Personal Income*	Jun '85	\$ 3,187	\$ 3,170	\$ 3,007
Leading Indicators Composite Index (1967=100) †	Jun '85n	168.5	166.9r	166.7
Industrial Production Index (1977=100) †	Jun '85	124.6	124.4	122.3
Net Change in Consumer Installment Credit †	May '85	\$ 9.04	\$ 8.27	\$ 9.09
U.S. Merchandise Trade Balance †	Jun '85n	-\$ 13.42	-\$ 12.67	-\$ 8.76
Plant and Equipment Expenditures*	3rd Q'85	\$392.61(a)	\$385.31(a)	\$361.12
Private Housing Starts (Thousands of Units)*	Jun '85	1,705	1,673	1,837
New Construction Expenditures*	Jun '85n	\$ 342.8	\$ 340.5r	\$ 317.8
Total Business Inventories †	May '85	\$ 577.9	\$ 580.2	\$ 550.5
Total Business Sales †	May '85	\$ 427.6	\$ 426.7	\$ 412.5

*Seasonally adjusted annual rate.

†Seasonally adjusted.

n-Newly reported figure.

r-Revised.

a-Anticipated.

what seems to be a low level of business inventories. In fact, lean inventories in most sectors suggest that any further upturn in demand will be translated into stepped-up production. And two powerful remedies now in place—lower interest rates and a lower exchange value of the dollar—also portend renewed economic vigor in the months ahead.

Most short-term interest rates are at their lowest levels since late 1978. Business spending on plant and equipment seems to be responding to these lower interest rates. Inflation-adjusted investment in new structures in the second quarter rose at a 19 percent annual rate, while spending on producers' durable equipment rose at an 11.4 percent pace.

The lower value of the dollar is expected to retard the further erosion of the U.S. net export position by slowing imports and improving the competitive strength of American exporters.

Further, it seems that the pace of business activity abroad may be picking up as well. Columbia University's Center for International Business Cycle Research reports that its index of leading indicators for eight major foreign countries has risen six percent in the last six months. Stronger growth abroad should increase foreign demand for U.S. goods and services. This will not only add to the pace of the U.S. expansion, it will also help to reduce our trade deficit.

H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since	
		Week Ago	Year Ago
Time Deposits of \$100,000 or more			
Weekly Reporting Banks			
Nationwide (7/17/85)	153,044	+ 177	- 4,026
New York City (7/24/85)	32,865	+ 310	- 2,423
Commercial Paper (7/24/85)	264,817	- 2,077	+ 39,169

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans			
	Latest Week	Change Since	
		Week Ago	Year Ago
Weekly Reporting Large Commercial Banks			
Nationwide (7/17/85)	252,943	- 214	+ 7,642
New York City (7/24/85)	59,639	- 65	- 4,802
Total Loans and Leases Gross Adjusted			
	Latest Week	Change Since	
		Week Ago	Year Ago
Nationwide (7/17/85)	683,031	+ 2,695	+ 63,640
New York City (7/24/85)	145,969	- 4,450	+ 6,807

Financial Markets

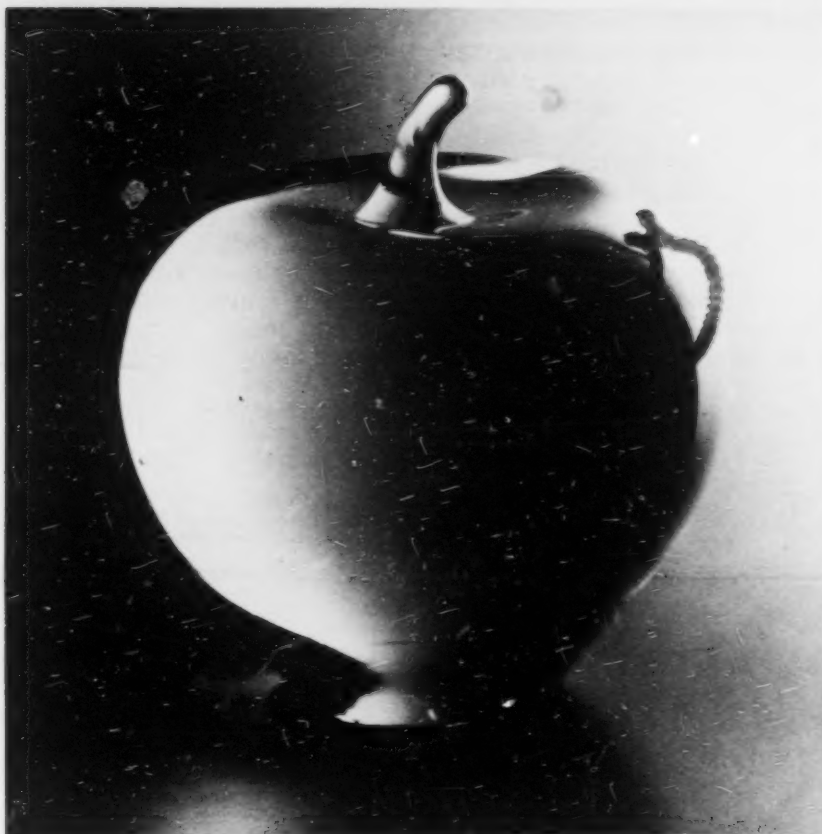
	Friday 8/2/85	Change Since	
		Week Ago	Year Ago
U.S. Governments, Closing Yields:			
90-Day Billst	7.53%	+ .12	- 3.34
180-Day Billst	7.88	+ .54	- 3.47
Longest Billst	8.22	+ .78	- 3.53
Recent Issues:			
87/8S 7/31/87	9.11	+ .13	
95/8S 6/30/89	9.86	+ .14	
111/4S 5/15/95	10.61	+ .04	
111/4S 2/15/15	10.73	+ .03	
Municipals:			
Bond Buyer-20 Bond Index* (8/1/85)	9.01%	+ .14	- .91
Blue List Total (\$ Million)	\$2,090	-\$ 828	+ \$1,076
30-Day Visible Supply (\$ Million)	\$2,948	-\$ 338	+ \$ 327
Total	\$5,038	-\$1,166	+ \$ 749
Corporates:			
Moody's Aa Composite (8/1/85)	11.53%	+ .06	- 2.06
30-Day Visible Supply (\$ Million)	\$3,453	-\$ 287	+ \$2,898
Stocks:			
Dow-Jones Averages:			
Industrials	1,353.05	- 4.03	+ 150.97
Transportation	699.44	+ 11.24	+ 173.77
Utilities	156.85	- .57	+ 30.36
65 Stocks	559.40	+ 1.30	+ 90.89
Standard and Poor's 500 Stocks	191.48	- .92	+ 29.13
N.Y.S.E. Composite Index	110.85	- .50	+ 17.62
N.Y.S.E. Avg. Daily Vol. for Week (000's)	106,528	-12,674	- 33,148

International Rates

	Friday 8/2/85	Week Ago
EURODOLLAR DEPOSIT RATES (bid)		
Overnight	7.94%	7.31%
1 month	7.94	7.88
3 month	8.13	8.13
6 month	8.38	8.38
1 year	8.75	8.69
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	10.35%	10.40%
Long Term (7 to 15 yrs.)	10.90	10.95
FOREIGN EXCHANGE SPOT RATES		
New York Opening	U.S. \$	Currency
(8/2/85)	Equivalent	Per U.S. \$
Belgium	.01747	57.2400
Canada	.7389	1.3533
Denmark	.09847	10.1550
France	.1157	8.6425
Germany	.3530	2.8330
Italy	.0005265	1899.50
Japan	.004209	237.58
Mexico	.002857	350.00
Netherlands	.3145	3.1800
Switzerland	.4310	2.3200
U.K.	1.3640	.7331

* 46% Taxable equivalent 16.69%.

† Bond equivalent.



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